
OVERVIEW OF BARBADOS ECONOMIC SUBSTANCE TEST UNDER THE COMPANIES (ECONOMIC SUBSTANCE) ACT, 2019-43

Introduction and Scope

The Companies (Economic Substance) Act, 2019-43 (the “**ESA**”) enacted on November 28, 2019 is the latest iteration of economic substance legislation in Barbados. The introduction of the ESA is accompanied by the Economic Substance Guidelines (the “**Guidelines**”), which provide guidance on the scope and application of the ESA. The latest version of the Guidelines (version 1.2), disseminated on May 25, 2020, confirms that the Guidelines have the force of law, per Section 18 (2) of the ESA. This Memo examines the provisions of both the ESA and the Guidelines and their application to companies within the scope of the said provisions.

ESA applies to Barbados resident companies which derive income from carrying on one or more “relevant activity” listed in the Act, namely¹: banking business, insurance business, fund management business, finance and leasing business, headquarters business, shipping business, and holding company business, intellectual property business, distribution and service centre business. These companies are required to satisfy the Economic Substance Test (the “**ES Test**”) prescribed by the Act. Further, pursuant to the Guidelines:

- 1) A resident company that was in existence prior to the commencement of the ESA must be in compliance with the ESA from January 1, 2019.
- 2) A resident company that was not in existence prior to the date of commencement of the ESA must be in compliance with the ESA from the date on which the said resident company commenced the relevant activity.
- 3) For “Grandfathered entities”² the effective date for compliance is January 1, 2021.

¹ the activities listed in section 4 of the ESA do not constitute to a closed list, as the Act imports an open-ended provision for: “*such other activities as the Minister may by order prescribe to be relevant activities.*”

² Entities which have been authorized to continue, for a limited period, to operate under the previous regulatory regime pursuant to the transitional statutory provisions of the International Business Companies (Repeal) Act 2018-40, the Insurance (Amendment) Act, 2018-52, the Financial Institutions (Amendment) Act, 2018-51, and/or the Societies with Restricted Liability (Amendment) Act, 2018-47.

While the ESA applies to Barbados resident companies³, the Guidelines expressly exclude from the definition of “resident company”: unincorporated associations (including general/limited partnerships), trusts; and companies/entities that are tax resident outside of Barbados.

The Test

*A resident company meets the economic substance test in relation to a relevant activity carried on by the company where it conducts its **core income generating activities in Barbados**, and the company is **directed, managed and controlled in Barbados** in relation to that activity.*

There are two components to the ES Test; a core income generating activities test (the “**CIGA test**”), and a direction and management test (the “**directed and managed test**”). A resident company that is carrying on more than one relevant activity is required to satisfy the ES Test in relation to each relevant activity.

The CIGA test focuses on activities that are of central importance in terms of generating income and requiring that there is proportionate operational expenditure, physical assets and employees with regards to the level of income earned from the performance of such activities. Resident companies must demonstrate that in relation to a relevant activity, CIGAs are actually performed in Barbados, and, having regard to the level of income derived from the relevant activity carried on: (a) there is an adequate number of qualified full-time employees in relation to that activity in Barbados; (b) there is an adequate number of employees who are physically present in Barbados in relation to that activity; (c) there is adequate operating expenditure incurred in Barbados; (d) there are adequate physical assets in Barbados. Companies may outsource the performance of CIGAs to local service providers, providing that the company is able to monitor and control such performance. Where CIGAs are outsourced, the resources and employees of the service provider can be treated as those of the resident company for the purpose of determining whether the employees and physical assets element of the CIGA test is met.

The directed and managed test is concerned with ensuring that important and strategic company decisions are made within Barbados. The test is satisfied where the directors hold meetings in Barbados, where a quorum is physically present, the directors have the necessary knowledge

³ Per the ESA, “resident company” means: (a) a company, whether incorporated in Barbados or elsewhere, or a society with restricted liability organised in Barbados, or an association formed in Barbados, other than an association of underwriters, which is managed and controlled in Barbados; or (b) a company incorporated outside Barbados, that is registered in Barbados as an external company that is not regarded as a tax resident company in the jurisdiction of incorporation; or (c) a company incorporated in Barbados as an entity but which is not tax resident in any other jurisdiction.

and expertise to discharge the duties of the board, the meeting minutes and company records are maintained in Barbados. What constitutes an adequate number of meetings in Barbados will be dependent on the relevant activities of the entity.

The ESA also prescribes a reduced ES Test (the “**Reduced Test**”) which applies a less stringent criteria for single purpose equity holding companies and companies that are beneficially owned or controlled by Barbadian residents, that engage in a relevant activity exclusively in Barbados and derive income solely from such relevant activities. Companies subject to the Reduced Test must demonstrate that they have adequate human resources and adequate physical assets in Barbados, and are compliant with all applicable regulatory filing requirements.

Compliance Framework

In order to demonstrate compliance with the ES Test, companies must submit an Economic Substance Declaration (the “**Declaration**”) on an annual basis in the prescribed form. A resident company that was in existence prior to the commencement of the ESA must be in compliance with the ESA from January 1, 2019. As such, if it is carrying on any relevant activity, it must file an economic substance declaration no later than 12 months after the end of its fiscal period commencing on or after January 1, 2019. Resident companies that were grandfathered pursuant to the Insurance Act, Cap. 310, Financial Institutions Act, Cap.324A, International Business Companies (Repeal) Act, 2018-40 and/or the Societies with Restricted Liability Act, Cap. 318B, must be in compliance with the ESA with effect from 1 January 2021. Grandfathered resident companies will therefore file an economic substance declaration no later than 12 months after the end of its fiscal period commencing on or after January 1, 2021. The Declaration must state:

- (a) whether or not they are carrying on a relevant activity;
- (b) whether or not they derive income from a relevant activity;
- (c) if the resident company is carrying on a relevant activity, whether or not all of the resident company’s income in relation to the relevant activity;
 - i) is subject to tax in a jurisdiction outside of Barbados; or
 - ii) is compliant with economic substance requirements in a jurisdiction outside of Barbados;
- (d) whether it is beneficially owned or controlled by residents of Barbados; and
- (e) the date of the end of its fiscal period.

The Guidelines further state that a resident company which is required to satisfy the ES Test must provide the business/income types identifying the type of relevant activity; amount and type of income by relevant activity; amount of operating expenditure by relevant activity; details of business address; number of (qualified) full time employees; confirmation of the CIGA conducted for each relevant activity; and confirmation of whether any CIGA have been outsourced and if so relevant details.

The Declaration and any additional documents as may be required by Director of International Business (the “**Director**”) must be filed by an officer of the company designated to handle all matters related to substance, a corporate and trust service provider or any other appointed officer. Where a resident company outsources to a service provider in Barbados, precise details of the resources employed by its service providers must be provided.

The Director is responsible for determining whether the ES Test is met and must render a decision no later than four years after the date of filing of the Declaration. The Director applies a “principles-based” approach to the determination. The ESA therefore imports a degree of flexibility into the ES Test, and there is no prescribed minimum/maximum number of full-time employees or other personnel for a particular level of income either generally or for any particular type of relevant activity.

The Guidelines also impose a requirement that companies retain documentary records (including those stored electronically) in relation to a relevant activity and/or that relates to information required by the Director for a period six years. The Director or a person authorized by him has the power to enter the premises of a company to examine/make copies of any business document, for the purpose of investigating any issue of compliance with the ESA.

Consequences of failing to meet the Test and non-compliance with the ESA

Where the Director determines that a company has failed to meet the ES Test, that company will be issued a notice within 21 days of the date of that determination notifying it of the failure and reasons for such failure. The notice will also indicate the amount of penalty imposed, and the due date of the penalty, being not less than 28 days after the issue of the notice. Additionally, it will indicate what action the Director considers should be taken by the company to meet the ES Test, and the company’s right to appeal the imposition/amount of the penalty.

Companies that have been issued a notice must rectify the breach and advise the Director of the rectification within 12 months from the date of notice. Failure to do so will attract a second

notice from the Director. A penalty for failure to meet the ES Test can be up to \$300,000 which is payable within 30 days of the date of notice of the imposition of the penalty. Where there is a failure to rectify a failure of the ES Test after two consecutive years, the company may be struck off the register. The ESA also prescribes a penalty of \$10,000 for a failure to provide information or for intentionally providing inaccurate information in the Declaration, or where the person filing the Declaration subsequently discovers some inaccuracy and fails to take reasonable steps to inform the Director.

In the event of a determination that a company has failed to meet the ES Test, the Director will forward the information provided by the delinquent company to the Barbados Revenue Authority, who in turn forwards it to the foreign competent authority of the holding and/or ultimate holding company of the delinquent resident company and its ultimate beneficial owner.

Liza A. Harridyal-Sodha

June 2020